

Russia

Russian budget surplus expected to shrink in the next few years. The consolidated budget forecast released in April sees budget revenues increasing this year at about 3 % p.a. and at around 4 % p.a. in 2020–2021. That is slightly below inflation. The forecast, which comprises federal, regional & local budgets and state social funds, extends to 2036.

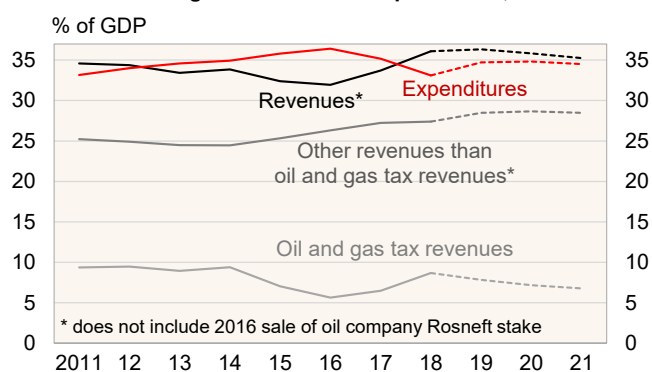
Revenues from oil & gas taxes substantially weigh on the revenue outlook. They rose hugely in 2018. This year they are expected to decline tangibly and then stay over 10 % smaller than last year. The estimate for the level of oil & gas tax revenues is unchanged from last autumn's forecast, as is the budget assumption about the price for Urals crude: over 63 dollars in 2019 and 58 dollars in 2021.

The GDP growth forecast for 2019–2021 also remains unchanged from last autumn, i.e. an acceleration in growth (1.3 % this year, 2 % in 2020 and over 3 % in 2021). The estimated level of other consolidated budget revenue streams than oil & gas tax revenues has risen a bit following last year's rapid rise that was also much faster than forecast (particularly profit tax and VAT revenues). They are expected to increase by 6–7 % this year and by about 6 % p.a. in 2020–2021 (the latter about the same pace as in last autumn's forecast).

The levels of consolidated budget spending estimates for 2019–2021 have been raised slightly after spending increased faster than forecast in 2018. The pace of spending growth remains very much the same as in last autumn's forecast at around 6 % p.a. or 1.5–2 % higher than inflation. Funding of national projects ordered in president Putin's May 2018 inaugural Decree is included in spending estimates.

The budget surplus will shrink this year to about 1.5 % of GDP and to 1 % of GDP next year. The calculational budget deficit at the fiscal rule's low oil price for the next few years is about 1.5 % of GDP. The rule mechanism will replenish the National Welfare Fund so that its liquid assets exceed 10 % of GDP in 2021 if no additional monies from the Fund are committed by e.g. granting loans for projects. This savings part of the rule forces the government to borrow to cover spending. The government debt will rise to 15.5 % of GDP in 2021.

Consolidated budget revenues and expenditures, 2011–2021



Sources: Finance ministry and BOFIT.

Little progress in reducing poverty, even as Russian living conditions generally improve. Every two years, Rosstat conducts a large nationwide household survey that covers widely living conditions, incomes, housing and health. The results of the latest survey, conducted in autumn 2018, were released at the end of March. The survey includes responses from 60,000 households across Russia.

The survey indicates economic hardship has diminished slightly for most households. In autumn 2018, half of responding households said they had sufficient assets to afford a one-week vacation away from home, up from 43 % of respondents two years ago. Two-thirds of households reported that they could afford at least two pairs of shoes for every family member each year, up from half of respondents in 2016.

Only slight inroads have been made in reducing extreme poverty, with 15 % of respondents reporting struggles to meet necessary expenses. Confirming this are Rosstat's latest income data, which show that 13 % of the population (19 million people) last year got by on incomes below the official subsistence minimum. Despite economic growth and hikes in minimum wages, however, the share of the population living in poverty has remained unchanged in the last few years. The survey questions also touched on problems related to living in neighbourhoods and districts. The most frequent sources of dissatisfaction were the poor quality of the road system and traffic safety. Lack of access to services or their poor quality was clearly less of an issue for the respondents.

Russian president tours East Asia. On April 25, Vladimir Putin hosted North Korea's leader Kim Jong-un in Vladivostok. He then continued to Beijing to participate in the Belt and Road Forum which is a meeting of countries who participate in the initiative led by China.

Putin discussed security issues and economic relations with Kim, although compliance with international sanction policy against North Korea restricts cooperation between the two countries. Even so, a large number of North Koreans are reportedly already employed in the Russian Far East, especially at construction sites. In addition, by controlling a piece of land between its neighbours, North Korea has some regional economic leverage. Possible rail and gas pipeline connections between Vladivostok and South Korea would have to cross its territory. Natural gas is already shipped by sea from Russia's Sakhalin Island to South Korea, but this requires liquefaction and regasification and is more expensive. However, pipes or tracks are unlikely to be built in the near future.

In connection with the Beijing forum, the Russian energy company Novatek announced that two Chinese state-owned oil companies, CNODC and CNOOC, would each be taking a 10 % stake in its planned Arctic LNG 2 gas liquefaction facility. The French energy company Total also committed earlier this year to a 10 % stake. According to the current plan, the facility would be built on the coast of the Gulf of Ob at the Arctic Sea and begin production in 2023. Novatek's new Yamal LNG facility has already started production on the opposite side of the gulf.

China

China tries to calm critics of Belt and Road Initiative.

President Xi Jinping announced the Belt and Road Initiative (BRI or New Silk Road) in 2013. The second BRI Forum was held last weekend in Beijing. Participants included presidents or prime ministers from 36 countries among a total of approximately 5,000 delegates. China's official BRI website claims the initiative embraces 130 countries. China reiterated its long-standing theme that the purpose of the BRI is to increase investment in infrastructure and promote international cooperation. The BRI has expanded in multiple directions over the years, so nowadays the Chinese even speak of an "Arctic Silk Road" or "Agricultural Silk Road" projects.

During the forum, president Xi announced the signing of new BRI contracts worth a total of 64 billion dollars. The figure seems quite high given that China's National Development and Reform Commission (NDRC) announced just before the forum that Chinese firms invested a total of 90 billion dollars in BRI countries during 2013–2018 and that Chinese banks have lent BRI countries roughly 200–300 billion dollars. Financial market data provider Refinitiv puts the total value of BRI projects globally at 3.67 trillion dollars.

The project has been criticised as neo-colonialism and that the aggressive lending to participating countries effectively ties them to China's apron strings. Criticism of BRI projects has increased recently, as have efforts of partner countries to review the value they receive from such projects. For example, a Malaysian BRI project involving the purchase of construction services for a Chinese rail line was put on ice in January until the parties agreed in April to reduce the project price tag by a third.

Beijing sharply disputes the criticism, so assuaging these fears were the major themes at the forum. In his opening address, president Xi emphasised the advantages of BRI projects for all parties, including their permanent nature, environmental friendliness and reasonable pricing. Mr. Xi also said that he would not tolerate corruption in any BRI project and called for transparency. A big problem with BRI loans has been that the loan terms, usually negotiated in secret, may confer exceptional remedies to the lender (China) in the event of default (e.g. seizure of all project assets). Chinese officials are also accused of bribing loan counterparties to assure smooth signing of the project documents.

This week the independent think tank Rhodium Group released a [note](#) on the renegotiations of Chinese debt granted to other countries. The note found that 40 Chinese loans to a total of 24 countries have been renegotiated. Nearly all of the loans were issued during this decade and went to countries participating in BRI projects. The Chinese typically reschedule or forgive some of the troubled loan. The forgiven amount is usually tiny relative to the size of the loan, however. According to the note, asset seizures are actually a rare occurrence. China in total has forgiven about 50 billion dollars in loans.

China's bourses claw back last year's losses. Share prices in China have been buoyed recently by expectations of continuing economic stimulus policies. Surprisingly strong GDP numbers, however, have dampened hopes for additional stimulus. Since the GDP figure was released on April 17, China's main share indices have declined, dropping by 6 % in Shanghai and 8 % in Shenzhen. For all of 2019, share prices are still up 23 % in Shanghai and 29 % in Shenzhen.

Stock index producer MSCI announced in February that it was gradually increasing the weighting of mainland Chinese shares in its indices starting in May. An initial weighting of 5 % of the market capitalisation of mainland Chinese shares was included in certain MSCI indices last June. This year weighting will quadruple in three phases to 20 %. MSCI is also introducing shares of smaller Chinese firms. The weighting of listed mainland Chinese stocks in the MSCI Emerging Markets Index should reach about 3.3 % of the index by the end of this year. The weighting of mainland Chinese stocks listed off-shore will rise to 28.6 %. Index producer FTSE Russell will also include a mainland Chinese stock component beginning next month. By March 2020, FTSE Russell expects the weighting of Chinese A-shares to reach 5.5 % of its FTSE Emerging Markets Index and 0.6 % of the FTSE Global All Cap Index.

Trading of foreign investors on mainland bourses via Stock Connect arrangements with Hong Kong has increased significantly in recent months in conjunction with increased trading activity in China. Nevertheless, the share of Stock Connect transactions relative to overall trading volumes has changed little and only accounts about 8 % of the daily trading volume in Shanghai and just 6 % in Shenzhen. At the end of last year, foreign ownership in mainland China stock markets was about 2.6 % of the total market cap. The value of foreign holdings fell late last year along with the fall in stock prices.

Shanghai is currently establishing a new Sci-Tech Innovation Board, which is scheduled to begin operations in June. The listing process under the new arrangement should be faster and easier than at present, and will not require e.g. that firms demonstrate a track record of profitability or place strict limits on listing prices. China's rules have forced the largest Chinese IPOs in recent years to be staged in Hong Kong or New York. The goal of the new listing process is to encourage Chinese tech giants to stage their IPOs in China.

Share prices in mainland China and Hong Kong



Sources: Macrobond and BOFIT.